

02-2-RPTT 06-26-02

## **STATEMENT OF AUDIT PROCEDURE**

### **Audits of Purported "Dummy/Strawman" Transfers in Connection with Real Estate Syndications**

#### **I. Background**

The New York City Real Property Transfer Tax ("RPTT") applies both to the transfer by deed or other instrument of an interest in real property and to the transfer of a controlling economic interest in real property. The latter refers to a transaction whereby a 50 percent or greater ownership interest in an entity that owns real property is transferred. The 50 percent ownership interest is measured by the fair market value or the combined voting power of the stock in a corporation or by the capital, profits or beneficial ownership in a partnership, trust or other entity. A transfer of a controlling interest can include the issuance of shares or interests in the entity. A series of transfers of ownership interests in an entity can constitute a controlling interest transfer if the transfers are pursuant to a plan. Transfers within three years are presumed to be pursuant to such a plan. Transfers pursuant to a syndication also are considered to be made pursuant to a plan. *See*, Title 19 Rules of the City of New York §23-02, "Controlling interest", par. (2), illustration (xiv).

However, the tax does not apply to certain types of transactions including:

A deed, instrument or transaction conveying or transferring real property or an economic interest therein from a mere agent, dummy, straw man or conduit to his principal or a deed, instrument or transaction conveying or transferring real property or an economic interest therein from the principal to his agent, dummy, straw man or conduit.

Ad. Code §11-2108(b)(7).

Investors use a variety of vehicles to acquire and finance the acquisition of real property in New York City. Frequently one or more promoters will form a partnership or limited liability company to acquire a property. These promoters may make a small capital contribution to that entity (hereafter referred to as the "owner/principal").

The funds to complete the acquisition are raised in whole or in part by selling interests in the owner/principal to investors through a public offering or private placement syndication. Additional funds may be obtained from lenders but generally such funds are provided on a short-term unsecured basis to be repaid out of the proceeds of the syndication or replaced with permanent financing. Generally the investors acquire a majority interest in the owner/principal through the syndication. If the syndication is completed or substantially completed before the owner/principal acquires the real property, the RPTT applies only to the purchase of the property by the owner/principal. However, if the owner/principal purchases the property prior to the syndication, the RPTT would apply twice. First to the purchase of the property by the owner/principal and again to the sales of interests in the owner/principal to investors if the investors acquire 50 percent or more of the entity. Although syndication promoters will time the transactions so as to avoid a double tax, occasionally that is not possible. In those cases, the promoters will use another entity (hereafter referred to as the "nominee") to acquire title to the property on behalf of the owner/principal and to hold the property only until the syndication can be completed or substantially completed. Thereafter, the nominee will transfer title to the property to the owner/principal. If properly structured and documented, the transfer of the property by the nominee to the owner/principal should qualify as a transfer from "a mere agent, dummy, straw man or conduit" to its principal.

## II. Scope

This Statement of Audit Procedure provides guidance to auditors in the RPTT Unit who, when auditing a transaction for which the taxpayer has claimed the "dummy/strawman" exemption, conclude that the transaction is a transfer from a nominee to an owner/principal as part of a real estate syndication as described above.

This Statement of Audit Procedure is not applicable in auditing a return relating to the acquisition of the property by the nominee.

This Statement of Audit Procedure shall apply to all open cases.

## III. Procedures

If the auditor concludes that all of the elements of the transaction conform to the procedures described below, the auditor may accept the return as filed claiming the "dummy/strawman" exemption. See paragraph 5 for procedures where one or more elements is missing.

1. Return. If the taxpayer is claiming an exemption from the RPTT under the "dummy/strawman" exception of Ad. Code section 11-2108.b(7), the taxpayer must check condition (h) on the Form NYC-RPT and complete Schedule E.

2. Documentation. The auditor should request the following documents if not attached to the Form NYC-RPT:

- nominee or agency agreement
- formation documents for the nominee (the certificate of limited partnership, certificate of incorporation or articles of organization for a limited liability company)
- syndication materials (the private placement or public offering materials sent to prospective investors)
- loan agreements and other financing documents for financing the acquisition of the property by the nominee or the owner/principal
- any other related documents

When reviewing the documents submitted, the auditor should look for the following:

A. Nominee or agency agreement. The nominee agreement should include the following elements:

- The agreement must have been entered into prior to the transfer of the property to the nominee
- The agreement should identify the property and provide that the purpose of the agreement is to facilitate the acquisition of that property by the owner/principal
- The agreement should provide that the nominee is acting for and on behalf of the owner/principal
- The agreement should provide that the nominee must acquire, hold, dispose of and otherwise deal with the property solely as directed by the owner/principal
- The nominee should have no discretionary authority or responsibility for the property
- The owner/principal should indemnify the nominee for any losses, expenses or damages resulting from the nominee's actions under the agreement
- The agreement should terminate within one year after the acquisition of the property by the nominee and should provide that the property will be transferred to the owner/principal on termination of the agreement

B. Formation documents for nominee. The organizational documents for the nominee should expressly provide that the nominee is being formed for the purpose of acquiring title to the property as a nominee for the owner/principal.

C. Syndication documents. The syndication documents should describe the transaction, particularly the nominee arrangement, consistent with the characterization of the transaction as a "dummy/strawman" transaction.

D. Financing documents. The documentation of any financing provided by lenders in connection with the acquisition of the property by the nominee should acknowledge the beneficial ownership by the owner/principal. Any financing documents should provide that such financing is for the limited period of the syndication and that it will be repaid out of the proceeds of the syndication and of any permanent financing following the transfer of the property from the nominee to the owner/principal.

E. Other documents. Any other documents executed in connection with the acquisition of the property and the syndication, such as the deed, the contract of sale or any assignment of the contract, should be consistent with the characterization of the transaction as a "dummy/strawman" transaction.

3. Duration. The nominee arrangement should be for a limited period of time. The transfer of the property from the nominee to the owner/principal should take place within one year after the acquisition by the nominee.

4. Consideration. There should be no consideration, other than a nominal amount not in excess of ten dollars, for the conveyance of the property from the nominee to the owner/principal. The property should not be conveyed subject to any indebtedness.

5. Missing factors. If any aspect of the transaction or the documentation submitted is missing or is inconsistent with the procedures outlined in this Statement of Audit Procedure, the auditor should contact the Unit Head of the RPTT Unit. The RPTT Unit Head may, after reviewing the case, allow or disallow the "dummy/strawman" exemption based on the facts and circumstances of the particular transaction.